ORIGINAL

No. 6389.

IN THE

United States Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Leonard J. Woodruff,

Appellant,

vs.

Hubert F. Laugharn, as Trustee in Bankruptcy of the Estate of Golden State Gem Company, a corporation, Bankrupt,

Appellee.

BRIEF OF APPELLEE.

ROBERT L. BEVERIDGE,
Attorney for Appellee.

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TOPICAL INDEX.

PAGE

Statement of the Case 3

The Issue 19

Answer to Appellant's Assignment of Errors 21

Argument 39

Points and Authorities and Appellee's Propositions of Law 40

(1) Jurisdiction 40

(2) Sufficiency of Amended Complaint and Proof 40

Equity Rule Number Sixty-five Prescribes the Master's Right to Examine Any Witness in Order That the Evidence May Be Used by the Court if Necessary. This Rule Succeeded Old Equity Rule Number Eighty-one of Federal Equity Procedure of the United States District Court 45

Powers and Duties of Special Master 46

Conclusion 47

TABLE OF CASES AND AUTHORITIES CITED.

CASES. PAGE

Atkinson v. Western D. Syndicate, 170 Cal. 503............ 47
Ballau v. Andrews Baking Co., 128 Cal. 562.................. 42
Bennett v. Wilson, 122 Cal. 509.. 46
Benson v. Harriman, 55 Cal. App. 483...... 47
Brent *et al.* v. Simpson, 233 Fed. 285................................ 41
Bush & Mallet Co. v. Helfing, 134 Cal. 676....'................ 43
Callaghan v. Meyers, 128 U. S. 666, 32 L. Ed. 547...... 44
Carr v. Fair, 122 S. W. 657.. 46
Cioli v. Kenouigios, 39 Cal. App. Dec. 376...................... 43
Citizens State Bank v. Joplin, 198 S. W. 370................ 46
Crawford v. Neal, 144 U. S. 596, 36 L. Ed. 552........... 44
Davis v. Winona Wagon Co., 120 Cal. 244..................... 42
Doris v. Schwartz, 155 U. S. 636, 39 L. Ed. 289............ 44
Ellwood v. Walter, 103 Ill. A, 219...................................... 46
Estate of Pusey, 180 Cal. 358.. 46
First National Bank v. Eastman, 144 Cal. 487.............. 43
Forbes v. Hyde, 31 Cal. 342... 46
Girard Ins. Co. v. Hooper, 162 U. S. 538, 40 L. Ed. 1062 44
Golden Hill Distilling Co. v. Logue, 243 Fed. 342.......... 41
Gray v. Brunnold, 140 Cal. 615.. 43
Hards v. Burton, 79 Ill. 504... 46
Harley *et al.* v. Devlin, 149 Fed. 268.................................. 41
Hawkins v. Daunenberg Co., *et al.,* 234 Fed. 752.......... 41
Henneway v. Thaxter, 150 Cal. 737.................................... 43
Horn v. The Volcano Water Co., 13 Cal. 62.................. 43
Johnston v. Forsyth Mercantile Co., 127 Fed. 845.......... 41
Kieiss v. Hotaling, 96 Cal. 617... 46
Kraver v. Abrahns, 203 Fed. 782....................................... 41
Lindsey v. Swift, 119 N. E. 787... 46

PAGE

McNulty v. Wilson, 158 Fed. 221 44

Milkman v. Arthe, *et al.*, 213 Fed. 642, 223 Fed. 507 41

Operators Piano Co. v. First Wisconsin Trust Co., 283 Fed. 904, 11 U. S. C. A. 96b, 107e 41

People v. Green, 74 Cal. 405 46

Phenegan v. Pavlini, 27 Cal. App. 381 47

Price v. Coolidge Banking Co. *et al.*, 242 Fed. 175 41

Rossen v. Villanueva, 175 Cal. 632 43

Ruggles v. Cannedy, 127 Cal. 290 42

Snow Iron Works v. Chadwick, 116 N. E. 801 46

Story v. Livingston, 10 L. Ed. 200 45

Title Insurance etc. Co. v. ...., 171 Cal. 173 43

Toledo Fence & Post Co. v. Lyons, 299 Fed. 637 41

Walker v. Rogers, 6 Johns. 566 45

Winstow v. Stabb *et al.*, 233 Fed. 304 41

AUTHORITIES.

Bankruptcy Act, paragraphs 60, 67 and 70 41

C. C. P., Section 473 45

Civil Code, Section 320a 43

Civil Code, Section 2955 42

Civil Code, Section 3007 42

Civil Code, Section 3440 42

21 C. J. 601 46

21 C. J. 601, paragraph 745-2 46

Cyclopedia of Federal Procedure, Vol. 1, page 574 41

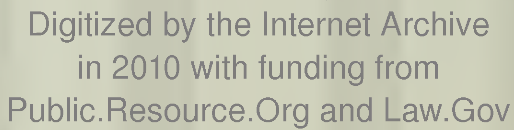
11 Fed. Second 2 N. B. 984 44

109 Fed. Rep. 177 46

299 Fed. 106 44

Judicial Code Laws of the U. S., paragraph 24 (1), U. S. C. A. 41 (1) 41

125 U. S. 149, 31 L. Ed. 664 44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IN THE

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Leonard J. Woodruff,
Appellant,
vs.
Hubert F. Laugharn, as Trustee in Bankruptcy of the Estate of Golden State Gem Company, a corporation, Bankrupt,
Appellee.

BRIEF OF APPELLEE.

STATEMENT OF THE CASE.

This is an appeal by appellant, Leonard J. Woodruff, from findings of fact and conclusions of law of Special Master and order and decree of the District Court of the United States, Southern District of California, Central Division, in favor of appellee, Hubert F. Laugharn, as trustee in bankruptcy of the estate of the Golden State Gem Company, a corporation, bankrupt.

The decisions appealed from follow [Tr. 81]:

"FINDINGS OF FACT, CONCLUSIONS OF LAW AND REPORT OF SPECIAL MASTER.

Appearances:

Robert L. Beveridge, Esq., for plaintiff (appellee);

J. A. Coleman, Esq., and Edward Fitzpatrick, Esq., for the defendants (appellant).

"This matter was referred to the undersigned as Special Master to make findings of fact, conclusions of law and report on the issues raised by the pleadings. These issues, although requiring a number of tedious days for trial, are not greatly complicated. Up to August 3, 1929, the bankrupt corporation had borrowed from Leonard J. Woodruff, the defendant in interest, all other defendants being his agents or nominal defendants, certain sums of money, the exact amount of which is unknown according to the testimony of the bankrupt's officers and employees. The books of the bankrupt were in its place of business at the time of the foreclosure and sale and the taking possession thereof by the defendant, and while I believe this testimony to be true the books have not been found by the trustee and the defendant's agent testified that he did not find them at the time of the sale and there is no evidence of the destruction of the books by him. The defendant, as will be hereinafter further considered, testified that his books were destroyed by a former secretary, who was not produced nor was any showing made of an effort made to produce him.

"The only checks produced by defendant showing payments to plaintiff prior to the date of the execution of the mortgage, as shown by Defendant's Exhibit H, five in number, total $11,475, and Defend-

ant's Exhibit N, one check for $950, totaling $12,425, and while the note and mortgage were executed by officers of the bankrupt corporation who had no knowledge of the amount due, in the absence of its president and general manager and by reason of the insistence of the defendant and his counsel yet written agreements of the character of this note and mortgage are of such evidentiary value that a finding must be made that the amount due at the time of the execution thereof was $18,000. The defendant produced checks showing the payments to the bankrupt after the execution of the mortgage (Def. Ex. I) amounting to $9,383, and the bankrupt's president admitted that a certain transaction amounted to $10,000, which would add the sum of $1240 to the checks produced, making total advances of $10,623, in addition to the $18,000 due at the time of the execution of the mortgage, a total of $28,623, a principal, for which the defendant has pledged to him the jewelry and semi-precious stones in a safety deposit box at the Security First National Bank of Los Angeles, 7th and Spring streets, Los Angeles, Calif.

"After the defendant testified that he had advanced other sums of money for which he did not have the checks, and that his books had been destroyed by a former secretary, I requested counsel for the plaintiff to have subpoenaed the records of the different banks in which the defendant stated he maintained accounts during this period of time, in order that I might ascertain if there was charged against his bank accounts on or about the dates the defendant claimed to have made such advances any checks in the same amount. This request on the part of the Special Master met with objection of counsel for defendant, and upon the production of the bank records no charges, with two exceptions, one of which was ac-

counted for by a check, were found against defendant's bank accounts comparing with amounts testified by him to have been paid them, for which he could not produce checks. There are instances in which books are destroyed, but there is practically always sources of information from which these books can be rewritten, and there are other means of proving such destruction other than the bare statement of a defendant made under such peculiar circumstances. This defendant is not a man of trivial business affairs, as evidenced by the records of his bank account. For instance, in one bank alone, the predecessor of the Bank of America, he maintained several accounts. In 1927 he deposited over $8000, and up to August 11, 1928, over $52,000. In another account, the First National Bank of Los Angeles (Def. Ex. P and Q-1-2-3-4-5), the following deposits were made:

December 3 to 31, 1926 (Def. Ex. Q-1)	$ 20,850.67
January 13 to 28, 1927 (Def. Ex. Q-2)	1,433.80
March 7 to 30, 1927 (Def. Ex. Q-3)	50.257.43
April 14 to 28, 1927 (Def. Ex. Q-4)	9,284.64
May 5 to 17, 1927 (Def. Ex. Q-5)	15,397.16
August 3 to 30, 1927 (Def. Ex. P)	52,019.74
Total	$149,243.44

"The above are the deposits in one bank for a nine months period, during which period of time in one other bank there was also a further deposit of $8000, and also in another bank, for the year 1928, up to August, over $52,000 was deposited, or total deposits of over $200,000 from December 3, 1926, to August 11, 1928. This is the financial record of a defendant who testified that he made no income tax return during these years and could supply no documentary evidence of his payments to the bankrupt.

"At the time of the execution of the mortgage the largest stockholder and manager of the bankrupt, Calvin Smith, was in the east endeavoring to refinance its affairs, and the defendant and his attorney demanded additional security for the existing indebtedness. In response to a telegram Calvin Smith replied that he had no objections to giving the defendant a mortgage, but asking for an explanation and requested that it be not signed without a further approval from him. The note and mortgage were executed without the holding of a meeting of the board of directors of the bankrupt corporation, without notice to such directors of a meeting or waiver of notice and consent to the holding thereof, are contrary to the requirements of the corporation's by-laws. The security given in the mortgage was the fixtures of the store used by the bankrupt and a large stock of semi-precious stones, jewelry, and mountings, and also the machinery and equipment used by the bankrupt in cutting and polishing stones. The bankrupt, in the operation of its business, occupied two store rooms, one of which was practically all used for the purpose of displaying and selling its merchandise, part of which was purchased ready for sale and part assembled and manufactured by it in the adjoining store room, which was largely occupied by the machinery for the cutting and polishing of stones.

"No argument or citation of authority is necessary to illustrate from these facts that the bankrupt was a merchant, and practically all of the property mortgaged was the stock in trade, furniture and fixtures of a merchant, although some of the stock was in a more or less uncompleted form, yet subject to sale and actually sold by the bankrupt in that form both at wholesale and retail. By reason of the fact that it engaged in manufacturing some of its own jewelry,

as well as jewelry for other parties, and cut and polished these semi-precious stones, it is not taken out of the class of a merchant, nor was the stock in trade which they were selling and had for sale taken out of the class of stock in trade of a merchant. Under section 2955 C. C., a mortgage on the stock in trade of a merchant is prohibited and void from its very inception.

"No notice of intention to execute a mortgage on the fixtures of the bankrupt was given as required by section 3440 C. C., which voided the mortgage as to such articles by reason of the fact that the bankrupt at that time came within the definition of a merchant. Later, after the validity of the mortgage was questioned by creditors, and the defendant, to protect the mortgage and compromise litigation concerning its validity, paid certain creditors, a conspiracy was entered into by the defendant and the president of the bankrupt corporation whereby it was agreed that in order to endeavor to protect the defendant, or in other words, to delay and defraud other creditors of the bankrupt, by securing an adjudication of the state courts as to the validity of the mortgage, the bankrupt permitted an action to foreclose the mortgage to go by default. The very purpose of that action demonstrates its invalidity, and even assuming that the findings of the state courts as to the proper execution of the mortgage could cure the absence of the authorization of such execution by the bankrupt's board of directors as against creditors bearing in mind that this mortgage was executed to give further security for a pre-existing indebtedness (which I do not assume to be the law) such findings and judgment based upon a fraudulent conspiracy cannot be otherwise than void.

"The reason for the foreclosure of the mortgage and the conspiracy between defendant Woodruff and the bankrupt's president is apparent from the evidence showing the endorsement of the bankrupt's note by the defendant (Pl. Ex. 7) to remove the bank as an objector to the mortgage, and the various difficulties which the defendant experienced with other creditors of the bankrupt, which is set forth in the application of J. A. Coleman, defendant's attorney, for fees for extraordinary services rendered in the ordinary services rendered in the foreclosure of the mortgage. [Tr. 262 to 268.]

"It therefore appears that the mortgage was and is void in the following particulars:

"First: As to the stock of merchandise of the bankrupt, which constituted the stock in trade of a merchant, by reason of the prohibition of section 2955 C. C.

"Second: As to the furniture and fixtures of the bankrupt, which was then a merchant, by reason of the absence of a notice of intention to mortgage as required by Sec. 3440 C. C.

"Third: As to the property above described in addition to the reasons therein set forth, and also as to the equipment used for the purpose of cutting and polishing the stones, by reason of the absence of the authorization of the board of directors of the bankrupt corporation for the execution of the mortgage.

"Before the execution of the mortgage and for the purpose of securing the defendant for funds already advanced and then about to be advanced, the bankrupt pledged with him certain jewelry and semi-precious stones, the value of which has not been accurately determined, but alleged to be between $20,000 and $78,000. By reason of the changes in market

conditions its true value will not be known until an effort has been made to effect a sale, but I am thoroughly convinced that the value of this pledged property will not equal the sum of $28,623 due on the pledge.

"Since the purported sale under the foreclosure of the chattel mortgage, the defendant has operated the store of the bankrupt (under trade name of Golden Coast Gem Co.) and no accounting made as to the profits of such operation or the proceeds of the sale of property in the store at the time of the foreclosure and sale. An exact accounting between the parties is difficult, but if this report be approved I recommend that an inventory be immediately taken of the mortgaged premises and that they be operated under the joint control of a representative of the trustee and of the defendant, pending an accounting between the parties, and that the trustee be given a reasonable length of time within which to sell the pledged jewelry and semi-precious stones, if such sale can be effected for a sum sufficient to pay the total amount of the advances of the defendant and interest, and in the event a sale cannot be effected at such price that such pledged property be delivered to the defendant and an accounting had between the parties as to the amount the trustee is entitled to recover from the defendant as the profits from the operation of the mortgaged property and proceeds of sales of portions thereof.

"The Special Master therefore finds as follows, to-wit:

I.

"That all the allegations of plaintiff's complaint are true.

II.

"That there was pledged to defendant Leonard Woodruff, located in a safety deposit box in the Security First National Bank of Los Angeles, 7th & Spring streets, Los Angeles, California, in the name of the defendant, entrance to which has been restrained by an order of the court, jewelry and semi-precious stones, the exact value of which is unknown, as security for the repayment to him of the following sums:

$18,000 with interest thereon at 6% per annum from August 3, 1927, compounded annually, amounting to the sum of $3434.74	$21,434.74
$500 with interest thereon at 7% per annum from December 5, 1927, amounting to the sum of $92.65	592.65
$200 with interest thereon at 7% per annum from February 27, 1928, amounting to the sum of $30.39	230.39
$500 with interest thereon at 7% per annum from April 4, 1928, amounting to the sum of $81.10	581.10
$6783 with interest thereon at 7% per annum from August 15, 1928, amounting to the sum of $928.51	7,711.51
$1200 with interest thereon at 7% per annum from August 15, 1928, amounting to the sum of $164.26	1,364.26
$1240 with interest thereon at 7% per annum from August 15, 1928, amounting to the sum of $169.79	1,409.79
Total	$33,324.44

"From the foregoing findings of fact the Special Master makes the following conclusions of law:

I.

"That plaintiff herein is the owner and entitled to possession of that certain store building situated at number 726 South San Pedro street, Los Angeles, California, together with such furniture, fixtures, equipment, stock in trade, and property of every kind or character as described in the said mortgage and in the said place of business at the time of the foreclosure of said mortgage.

II.

"That plaintiff is entitled to a reasonable length of time in which to make a sale of the said jewelry and semi-precious stones located in the safety deposit box at the Security First National Bank of Los Angeles, 7th and Spring streets, Los Angeles, California, in the name of the defendant, provided said sale can be made for a sum sufficient to pay defendant Leonard Woodruff all sums due him on principal and interest as found herein, and in the event said sale cannot be made that said property be delivered to defendant Leonard Woodruff.

III.

"That plaintiff is entitled to an accounting from defendant Leonard Woodruff as to such property as was in the said place of business of said Golden State Gem Company on the date of the foreclosure of the sale and sold by said defendant, and for the profits of the operation of said business.

"The Special Master asks that for his services rendered herein he be allowed a fee of $350, and that a confirmation of this report constitute an approval of such allowance.

"The Special Master transmits with this report the following documents:

"1. Pleading file, containing all the pleadings.

"2. Exhibit file, containing Plaintiff's Exhibits I to II inc., and Defendant's Exhibits A to Q inc.

Dated July 29, 1930.

Respectfully submitted,

(Signed) EARL E. MOSS,
Special Master."

After appellee filed exceptions to the foregoing findings of fact and conclusions of law, upon hearing thereon, September 17th, 1930, the District Court decided as follows [Tr. 385]:

"The exceptions of Leonard J. Woodruff, to findings of fact, conclusions of law, and report of Special Master herein, are and each is, overruled and denied, and an exception is hereby noted for said defendant to each of the aforesaid rulings, and it is accordingly ordered that findings of fact, conclusions of law, and report of Special Master, be, and the same are hereby confirmed and adopted as the decision of this court, and it is ordered that the Special Master herein be allowed a fee of three hundred and fifty dollars ($350.00) for services as such Special Master to the date hereof; and it is further ordered that a decree be entered herein pursuant to the report of said Special Master and as recommended therein, and sixty (60) days from the date of said decree is hereby determined to be a reasonable length of time in which to make a sale as recommended in said Master's report and in paragraph II of the Conclusions of Law therein; and Earl E. Moss, Esq., be and he is hereby appointed Special Master for the purpose of taking and making the accounting hereby ordered, pursuant to paragraph III of the Conclusions of Law and the report of said Special Master herein. The said decree

hereby ordered, to be with costs to plaintiff herein. Solicitors for paintiff will accordingly prepare, serve, and present for signing and entry herein, a decree in accordance with the foregoing order and pursuant to said report of said Special Master under the rules of this court. Dated at Los Angeles, California, September 17th, 1930."

In accordance with the foregoing order the following decree was rendered October 4th, 1930 [Tr. 386]:

"Decree and Special Reference for Final Judgment.

"The above entitled matter came on regularly for hearing September 2nd, 1930, in the above entitled court, Honorable Paul J. McCormick, Judge, presiding, plaintiff appearing by Robert L. Beveridge, Esq., of counsel, and the principal defendants Leonard Woodruff, trading as Golden Coast Gem Co., Leonard Woodruff individually, and J. T. Carroll as agent for Leonard Woodruff, trading as Golden Coast Gem Co., appearing by their attorneys Messrs. John A. Coleman and Edward Fitzpatrick, and the action being dismissed as to the nominal defendants, Golden State Gem Co. of Nevada, a corporation; Walter Calvin Smith, C. R. Buck and A. S. Devoll, upon the issues made up by the following pleadings and proceedings herein:

"Upon plaintiff's original petition; separate motions to dismiss as to defendants Leonard Woodruff, trading as Golden Coast Gem Co., Leonard Woodruff individually, and J. T. Carroll; separate answers of Leonard Woodruff and J. T. Carroll; demurrer of plaintiff to each of said separate answers; separate amended answers of defendants Leonard Woodruff and J. T. Carroll; plaintiff's demurrer and motion to

strike said separate answers; plaintiff's motion to have cause referred to a Special Master for findings of fact and conclusions of law, an order having been entered referring said matter for trial to E. E. Moss as Special Master to report his findings of fact and conclusions of law; on the preliminary report of Special Master including his oath of office and recommending granting permission to plaintiff to amend petition; upon plaintiff's motion for leave to file amended petition; upon the separate motions of defendants Leonard Woodruff and J. T. Carroll to dismiss said amended petition; upon the court's order re-referring said matter to E. E. Moss, Special Master, to hear and determine all questions of law and fact and report thereon; upon the court's order granting plaintiff leave to file an amended petition; upon plaintiff's amended petition and separate answers of the defendants Leonard Woodruff and J. T. Carroll thereto; upon the report and findings of fact and conclusions of law of the Special Master finding in favor of plaintiff herein; upon nine volumes of the transcript of evidence taken before the Special Master; upon the fifteen exceptions to the report of the Special Master taken by the defendants Leonard Woodruff and J. T. Carroll; upon the argument of respective counsel; upon all issues of fact and law raised by the aforesaid pleadings and reports, each side having submitted points and authorities of law and fact in support of their respective contentions herein, said matter having been by this court taken under submission on the date first above mentioned, and the court having been fully advised in the premises and having considered the issues raised by law in the pleadings and reports herein, and having considered the exceptions of the defendants Leonard Woodruff and J. T. Carroll to the findings of fact, conclusions

of law and report of Special Master, and having entered a minute order September 17th, overruling and denying the same,

"Now wherefore, by reason of the order that the findings of fact and conclusions of law and report of Special Master have been confirmed and adopted as the decision of this court, it is ordered, adjudged and decreed that the plaintiff have and recover judgment against the defendants Leonard Woodruff, trading as Golden Coast Gem Co., Leonard Woodruff individually, and J. T. Carroll, agent for Leonard Woodruff, trading as Golden Coast Gem Co., as follows:

"Plaintiff herein is the owner and entitled to possession of all of the property described in the chattel mortgage attached to plaintiff's petition wherever situated and for judgment for value thereof for such property as defendants or either of them are unable to surrender in accordance with this decree;

"That plaintiff be allowed sixty days from the date hereof in which to make a sale of that certain pledged jewelry and semi-precious stones located in the safety deposit box at the Security First National Bank of Los Angeles, 7th & Spring streets, Los Angeles, California, in the name of the defendant Leonard Woodruff, and it is further ordered that if said sale cannot be made for a sum sufficient to pay the defendant Leonard Woodruff the sum of thirty-three thousand, three hundred and twenty-four and 44/100 dollars ($33,324.44) and interest as found due him in the Special Master's report, then and in that event plaintiff herein is to deliver said property to defendant Leonard Woodruff in full and complete settlement of his pledge; that in the event said sale can be made for a sum so found due, then and in that event the residue thereof shall be used by plaintiff herein together with other sums coming into his hands to be distributed

among the creditors of the bankrupt estate, Golden State Gem Co., a corporation.

"It is further ordered, adjudged and decreed that said chattel mortgage as in plaintiff's complaint referred to be set aside; that the judgment resulting from the foreclosure proceedings thereof be decreed to have been procured by a fraudulent conspiracy and is void; that the sale that resulted from said foreclosure proceedings is hereby set aside and held for naught.

"It is further ordered, adjudged and decreed that E. E. Moss, Esq., be and he is hereby appointed Special Master for the purpose of receiving the report of plaintiff herein as to his sale or disposition of the pledged jewelry and semi-precious stones as herein authorized to be sold and disposed of, and for the further purpose of taking and making an accounting from the defendants Leonard Woodruff and J. T. Carroll, as to such property described in the said chattel mortgage as was in the said place of business of said Golden State Gem Co., a corporation, bankrupt herein, on the date of the foreclosure and subsequent sale thereof to said defendant Leonard Woodruff, and for the profits of the operation of such business.

"The said E. E. Moss, Esq., as such Special Master is hereby directed and authorized to report the result of plaintiff's doings in the matter of the sale or disposition of said pledged jewelry and semi-precious stones, and the result of his accounting and findings in the matter of the property covered by the chattel mortgage herein set aside for the further consideration and final judgment of this court; and

"It is further ordered, adjudged and decreed that the plaintiff, Hubert F. Laugharn, as trustee in bank-

ruptcy of the estate of Golden State Gem Co., a corporation, bankrupt, do have and recover judgment from the defendants Leonard Woodruff, trading as Golden Coast Gem Co., Leonard Woodruff individually and J. T. Carroll, agent for Leonard Woodruff, trading as Golden Coast Gem Co., for his costs, expenses and disbursements herein incurred as follows: Three hundred and fifty dollars ($350.00) for expenses for the services of E. E. Moss, Esq., Special Master herein, for costs and disbursements as shown by plaintiff's memorandum of costs and disbursements herein filed and as assessed herein at $123.99 [Tr. 392], as well as judgment for accruing costs, expenses and disbursements to effect final judgment herein, as may be hereinafter allowed.

"Dated this 4th day of October, 1930.

By the Court.

PAUL J. MCCORMICK,
U. S. District Judge."

Recorded and entered Oct. 13, 1930.

The case that resulted in these decisions was started in the said District Court of the United States, Southern District of California, Central Division, at Los Angeles, California, January 2nd, 1930, when and wherein appellee sued appellant and others, in a plenary proceeding, arising out of the bankruptcy proceedings of the Golden State Gem Company, a corporation, bankrupt, to recover for the benefit of creditors of said bankrupt estate assets alleged and proved to have been fraudulently transferred by bankrupt corporation to appellant to defraud creditors of bankrupt corporation in existence at said time.

The said transfer so alleged and proved to have been fraudulent, and accordingly decreed by the trial court and

the said District Court to have been void, consisted of a chattel mortgage, executed and delivered by bankrupt corporation to appellant August 3rd, 1927, to secure an alleged promissory note covering all of bankrupt corporation's stock in trade, furniture, numerous stones, and jewelry merchandise, fixtures and machinery, equipment and personal property, located at its then place of business, 726 South San Pedro street, Los Angeles, California.

An attempt was made by appellant and the bankrupt corporation to cure the legal defects of said transfer, as are more fully hereinafter referred to, by clearing said chattel mortgage in the Superior Court of Los Angeles county through default foreclosure proceedings and at a sale thereunder said property was bid in by appellant to satisfy the alleged indebtedness of eighteen thousand dollars ($18,000.00). These proceedings resulted from a conspiracy between bankrupt corporation and appellant to hinder, delay and defraud creditors of bankrupt corporation whose claims were in existence at said time and as yet unpaid, which said claims are now on file against bankrupt estate.

THE ISSUE.

Is the chattel mortgage in question and the subsequent sale under foreclosure proceedings thereof void, as having resulted from a conspiracy between appellant and bankrupt corporation to hinder, delay and defraud bankrupt corporation's creditors, and having been executed in violation of, and by failing to comply with sections 2955, 3440 and 320 (a) of the Civil Code of the state of California, and for want of proper authority and consideration?

In rendering the above decisions the Special Master and the District Court answered this issue in the affirmative finding that the chattel mortgage and the sale under the foreclosure thereof were void in the following particulars:

First: As to the stock of merchandise of bankrupt, which consisted of the stock in trade of a merchant, by reason of the prohibition of section 2955 of the Civil Code of the state of California.

Second: As to the furniture and fixtures of the bankrupt, which was then a merchant, by reason of the absence of the recordation of a seven-day notice of intention to mortgage as required by section 3440 of the Civil Code of the state of California.

Third: The execution of said chattel mortgage was not regularly authorized at a meeting of the board of directors of bankrupt corporation or at all, as provided by its by-laws (sections 8 and 9).

Fourth: That at the said time appellant had seventy-eight thousand dollars' ($78,000.00) worth of pledged property in his possession belonging to bankrupt corporation as security for indebtedness owing, and accordingly there was no consideration for said chattel mortgage and same was given by bankrupt corporation to appellant to hinder, delay and defraud its creditors whose claims were in existence at said time and are still unpaid.

Fifth: With reference to the foreclosure of said chattel mortgage and the sale thereunder, the same resulted from an agreement and conspiracy between appellant and bankrupt corporation to permit said proceedings to go by default to defraud the creditors of bankrupt corporation then in existence whose claims are now on file against bankrupt estate.

ANSWER TO APPELLANT'S ASSIGNMENT OF ERRORS.

In answer to appellant's assignment of errors an examination of the record will disclose that he is precluded from setting forth Proposition I, for the following reasons:

Before the case had been referred to a Special Master by order of the District Court [Tr. 45] under date of May 15th, 1930, for trial, the sufficiency of the original complaint had been passed upon by said District Court by the denial of a motion for a dismissal in the nature of a demurrer, February 17th, 1930.

However, out of consideration for some points raised by counsel for appellant, Special Master made a most careful examination of the allegations in appellee's complaint with reference to his objections to the introductions of any evidence on the ground that the complaint did not state facts sufficient to constitute a cause of action.

The motion for a dismissal before the Special Master was out of order for the sufficiency of the complaint had already been determined before the reference and the evidence accordingly should have been received without the long dissertation and final decision to amend.

Although the Special Master did not take into account that the sufficiency of the complaint had previously been settled by the District Court, nevertheless, as a master in chancery, under a general order of reference, he has the right to make what inquiries of the witnesses he deems proper or make any recommendations he may see fit to either party in the litigation regarding amendments to pleadings.

The amendment, however, referred to was not made on the motion or at the suggestion of the Special Master, but was made on motion of counsel for appellee and leave therefor was granted by the District Court. The only recommendation of the Special Master was that the permission for leave to amend by appellee be granted by the District Court. [Tr. 46 and 48 to 54.]

With reference to appellant's second assignment of error, to-wit: that the District Court erred in overruling and denying appellant's motion to dismiss plaintiff's original petition filed herein, this assignment of error is meaningless inasmuch as the case proceeded to trial based on an amended complaint that was thereafter allowed to be filed by the District Court.

With reference to appellant's third assignment of error, to-wit: that the District Court erred in overruling and denying appellant's motion to dismiss plaintiff's amended complaint filed herein, a perusal of said amended complaint [Tr. 54] will show conclusively that facts sufficient to constitute a cause of action in substance have been stated as follows:

(a) That during the time referred to in the complaint bankrupt corporation was engaged in the business of a wholesale and retail jewelry merchant and was accordingly subjected to the provisions of section 3440 and bound by the prohibition of section 2955, paragraph III of the Civil Code of the state of California, in the matter of mortgaging any of its personal property;

(b) That said chattel mortgage was not regularly authorized by directors of bankrupt corporation;

(c) That it was fraudulent and void in that it did not comply with section 3440 of the Civil Code of the state of California, and violated the prohibition of section 2955, paragraph III of the Civil Code of the state of California in that it attempted to mortgage the stock in trade, furniture and fixtures of a merchant, it having been alleged that the bankrupt corporation was a wholesale and retail jewelry merchant;

(d) That the subsequent foreclosure of said chattel mortgage and sale thereunder resulted from a conspiracy between appellant Leonard Woodruff and bankrupt corporation to permit said proceedings to go by default to hinder, delay and defraud creditors then in existence and to prevent the then existing judgment creditors from levying execution upon the property of bankrupt corporation. Appellee's second cause of action was withdrawn from the amended complaint for the reason that the subject matter thereof could be disposed of in summary proceedings in the bankrupt's estate proper, the court's attention being called to the fact that the Special Master who tried this case is the same person as the referee in bankruptcy proceedings. However, the Special Master ruled on the subject matter thereof in his decision for the reason that he had jurisdiction of the "*res*" and the parties concerned in the original and amended complaint as follows:

While the evidence shows that the bankrupt corporation did actually owe defendant Leonard Woodruff eighteen thousand dollars ($18,000.00) or more, it further shows conclusively that this money was given at a prior time than the date of the chattel mortgage but that to secure the same at such time the money was advanced to bank-

rupt corporation by the defendant Leonard Woodruff, appellant herein, bankrupt corporation pledged stock in favor of Leonard Woodruff in the amount of approximately seventy-eight thousand dollars ($78,000.00), which said stock was taken by defendant Leonard Woodruff as security for said indebtedness, and the said chattel mortgage given practically two years thereafter was merely to prevent judgment creditors from levying execution upon the property of bankrupt corporation and/or to hinder, delay and defraud the creditors whose claims were not in judgment.

In order to answer assignment of error IV, in which appellant states that the Special Master erred in making findings of fact I, being as follows, to-wit:

> "That all the allegations of plaintiff's complaint are true,"

it will be necessary to somewhat briefly review the evidence of the witnesses and accordingly the evidence will not be set forth in any other section of this brief:

Mrs. Cary E. Buck, appellee's witness [Tr. 135 to 143], testified that she was secretary of bankrupt corporation; that as such she signed the chattel mortgage together with A. S. Devoll, vice president, in the absence from the city of the other three directors; that she did not have any knowledge that the creditor Leonard Woodruff, defendant and appellant herein, had other security, to-wit, seventy-eight thousand dollars' ($78,000.00) worth of pledged stock to secure his indebtedness; that because he was the heaviest creditor he had persuaded her to execute the chattel mortgage to protect himself; that she wired her brother, Calvin Smith, president of the bankrupt corpora-

tion, for his O. K. without calling a director's meeting and having the execution of the chattel mortgage regularly authorized by a meeting of the board of directors, in accordance with sections 8 and 9 of the corporation's by-laws. (Telegram referred to as O. K. came day after mortgage date, Aug. 4, 1927 [Tr. 242, Deft.'s Ex. A], reading as follows: "It is alright to sign anything Leonard wants. I am looking after his interests. Why the chattel mortgage. Wire me more fully reasons. Await my answer and then sign.) In view of this situation this witness cleared herself in the eyes of the trial court by appearing not to know of the prior security posted to secure the creditor appellant herein against any loss on his claim. This witness testified that as secretary she did not record a seven (7) day notice of intention to execute the chattel mortgage; that no meeting was called or notice ever given to the other directors of the corporation regarding the transaction. She further testified that the creditors who were listed upon the schedules of the bankrupt corporation whose claims were then unpaid when scheduled were in existence at the time of said chattel mortgage. With reference to the nature of bankrupt corporation's business this witness testified as follows:

> "At the time my brother proposed the incorporation, we had a jewelry store at 726-28 South San Pedro street, where we did stone cutting and gem cutting and jewelry repairing; I was clerking as well as gem cutting. The corporation's principal line of business was selling diamonds and jewelry. We also had diamonds on display. I could not give you the amount."

This witness further testified [Tr. 352 to 358] that to the best of her knowledge the creditors whose claims were

scheduled in bankruptcy had claims in existence at the time the chattel mortgage was executed; that she did not receive any money from the defendant Leonard Woodruff the day she signed the mortgage [Tr. 361-362]; which evidence shows that there was no consideration passed at any time for the chattel mortgage; when this witness was asked the question [Tr. 363], "Was there anything said about any other security put up for the eighteen thousand dollars ($18,000.00)?" witness answered, "No, I did not know about that."

Witness John W. Hilton, on behalf of appellee, testified as follows:

That as a director he was not notified to attend any meeting of the board of directors to authorize the issuance of the mortgage; that in accordance with the corporation's by-laws that he never signed any written consent to the calling of the meeting and did not sign any waiver of notice thereof. Section 8 of the by-laws of the Golden State Gem Company, a corporation [Plaintiff's Exhibit 5, Tr. 155-6], reads as follows:

> "When any special meeting of the board of directors is called the notice of such special meeting shall state the time, place and purpose of such meeting, and no business other than as specified in such notice shall be transacted at such special meeting unless all of the directors shall by written assent incorporated in the minutes of such meeting, consent to the transaction thereat of other business."

Section 9 of the by-laws entitled, "Waiver of Notice," reads as follows:

> "When all the directors are present at any directors' meeting, however called or noticed, and sign a

> written consent thereto on the records of such meeting, or, if a majority of the directors are present, and if those not present sign in writing a waiver of notice of such meeting, which waiver is presented and made a part of the records of such meeting, the transactions thereof are as valid as if had at a meeting regularly called and noticed as provided by section 320a of the Civil Code of the state of California."

All of the witnesses by their evidence corroborate this witness in that these sections were not complied with, preceding the execution and delivery of the mortgage; this witness further testified that he was in the state of Nevada at the time [Tr. 158]; that in the store of bankrupt corporation there was all classes of jewelry on display, there were some watches and rings, pins and necklaces. Everything from cheap type stones that had a value of twenty-five cents (25¢) apiece up to diamonds worth hundreds of dollars. Half of the place of business was devoted to display of these articles. There were two rooms just about the same size, half was the factory, and the other half the sales room. There were from two to five employed in the sales room, depending upon the season of the year. Around Christmas there were more. With the members of the board, the directors, we did both lapidary and sales work; that at the time this mortgage was executed Mr. Smith, the president of bankrupt corporation, myself and a third director, the president's father, were away. "They were trying to raise funds. The management of the business more or less fell on his sister's shoulders (Mrs. Buck). There were quite a few bills pressing. They didn't know just exactly how to handle them so Mrs. Buck tried to get in touch with Mr. Woodruff and

get some additional money. Mr. Coleman (the attorney for Woodruff) suggested the idea of a mortgage in order to keep these bills from pressing; they could file a chattel mortgage and have a priority over these bills because the loan was already up. There was no consideration for the security had already been put up. This mortgage was to be a chattel mortgage on the business in spite of the collateral, rather the security, that was down at the bank." The witness stated that he so testified in bankruptcy proceedings, in answer to a question, as to the circumstances under which the chattel mortgage was executed; he further stated that he did not know anything about the foreclosure proceedings until the appellant herein, Leonard Woodruff, took possession of all the property after the sale. [Tr. 163, 164.]

Witness Mrs. Nanny Warnekros [Tr. 114, 143, 145 and 150] testified that she was a creditor of bankrupt corporation from the time of its incorporation until the time it was adjudicated bankrupt and her claim was as yet unpaid and was on file against the bankrupt estate covered by a promissory note in the original amount of seven thousand two hundred dollars ($7,200.00). The witness Miss E. A. Murray [Tr. 164] testified on behalf of another creditor of bankrupt corporation, namely, the Vogue Company, that there was a balance as yet unpaid upon an account that was incurred and in existence at the time the chattel mortgage was executed.

Although the witness Calvin Smith, president of the bankrupt corporation, testified [Tr. 167] that he believed he was in Los Angeles on or about the 3rd day of August, 1927, the date the mortgage was executed, later on in his

testimony [Tr. 174] he corrected his evidence to read that he was in the East; that he never received any notice of a special meeting authorizing the execution and delivery of the chattel mortgage; that he never caused to be called such a meeting and did not sign a consent or waiver of notice of such a meeting; that his corporation conducted a wholesale and retail merchandising jewelry business, gem cutting and manufacturing. He testified that the items described in the first paragraph of the chattel mortgage were used in the cutting and manufacturing of gems and jewelry the value thereof was ten thousand dollars ($10,000.00); that the items described in the second paragraph of the chattel mortgage, to-wit: twelve (12) stools and benches, etc., were used to do merchandise work in the wholesale and retail jewelry establishment [Exhibit "A," Tr. 37]; that the rest of the items described were specimens and jewelry merchandise that were kept in the store for the purpose of selling. A lot of these were in the rough and a lot were finished materials, some used for cutting and polishing and most all just for selling. He stated even the rough material was sold in the rough as well as finished to collectors and to private people who wanted the specimens of these stones. The corporation sold these articles cut and uncut to both private people and stores, both finished products and mounted; that the uncut gems and so-called rough merchandise was bought from the different miners of this gem material; that good-sized quantities in the rough were very often sold without any labor thereon; that orders were continually filled for different quantities of materials in the raw every day the year around. This witness further testified that the value

of the articles described at beginning of paragraph III starting, "Two hundred (200) pounds petrified wood" up to and including the articles described and ending with "One hundred (100) Kt. spinel, thirty-five (35) Kt. rubies, three hundred seventy-five (375) Kt. sapphires" [Exhibit "A," Tr. 37], was about fifty thousand dollars ($50,000.00), conservatively estimated. With reference to the purported consideration of the mortgage the witness Calvin Smith, president of the bankrupt corporation, testified that it was true that the Golden State Gem Company owed Mr. Woodruff eighteen thousand dollars ($18,-000.00), but the same was owing against pledged goods, namely, seventy-eight thousand dollars' ($78,000.00) worth of semi-precious and precious stones that had been placed on deposit in the name of Leonard Woodruff in a safety deposit box in the Security-First National Bank, Seventh and Spring streets, Los Angeles, California. [Tr. 183.] With reference to the alleged conspiracy between bankrupt corporation and Leonard Woodruff regarding the foreclosure of the chattel mortgage the witness Smith testified that he permitted the proceedings to go by default in consideration of the said Leonard Woodruff promissing to pay all claims then in existence but so long as things would be straightened up with everybody the witness testified that he was the loser by many times more than other people were.

With reference to the allegation about claims being in existence, during the life of the chattel mortgage, and at and about the time of its purported foreclosure, appellant's own testimony being that of his attorney, J. A. Coleman [Tr. 257 to 270, especially 262], shows that in

the state court proceedings herein referred to he was required to do the necessary to either pay for releases or have attachments dismissed by the filing of third party claims in the following entitled cases then pending against bankrupt corporation, in the matter of appearing to protect the interest of appellant, namely: Davidson v. Golden State Gem Co., No. 237532; National Credit Exchange v. Golden State Gem Co., Merchants National Bank v. Golden State Gem Co., the evidence shows that this claim was paid by Leonard Woodruff for the release of this attachment; that the Miller and Kosches Bros. claims were on file against bankrupt estate and unpaid.

In the foreclosure proceedings Attorney J. A. Coleman made application for extraordinary fee [Tr. 262] because as he stated therein that in each of these cases the plaintiffs attached the property mentioned in the mortgage set forth in the plaintiff's complaint; that in each and all of said cases Woodruff was compelled to employ Coleman as attorney to prepare and file his claim as mortgagee to procure a release of the said attachments. The evidence shows that such creditors that questioned the validity of the mortgage at said time threatened to bring suit to have the whole proceeding set aside but that to prevent the same the said Woodruff paid off such threatening creditors.

All in all the evidence of appellant's witnesses referred to, not to say anything about other evidence by other witnesses too voluminous to mention, shows conclusively that there is ample evidence to support the allegation that the said chattel mortgage was made and executed without consideration; that under sections 3440 and 2955, para-

graph 3 of the Civil Code of the state of California, it was fraudulent as to existing creditors and that there was a conspiracy between bankrupt corporation and appellant Woodruff in permitting said foreclosure proceedings to go by default although said conspiracy was innocent in a way in so far as bankrupt corporation was concerned in that bankrupt corporation relied upon Woodruff's representation that he would take care of other claims which he did not do. Accordingly the Special Master, Earl E. Moss, did not err in making his findings of fact that all of the allegations of plaintiff's complaint are true and for the further reason that all of the other defendants defaulted and admitted the said allegations to be true.

In this connection the Honorable Circuit Court's attention is especially called to the fact that at the beginning of these proceedings, besides this specially answering and appealing defendant, there were a number of other defendants who were served with process, namely, Golden State Gem Co. of Nevada, a corporation; J. T. Carrol, agent for Leonard Woodruff, trading as Golden Coast Gem Co.; Walter Calvin Smith, C. E. Buck and A. S. DeVoll, the latter three defendants being directors of bankrupt corporation, Golden State Gem Co. (The director, Hilton, having been unknown, was not joined; and the fifth director, father of the president, had died between date of mortgage and starting of this action.) The fact that all these defendants, excepting this specially answering and specially appealing defendant and his agent, have defaulted is conclusive proof as to the aforesaid defendants that the petition as to them is true. However, inas-

much as all of the property that is the subject matter of the litigation is in the possession of this appealing defendant, Leonard Woodruff, appellant herein, and he is endeavoring by this appeal to attempt to remain in possession thereof, these other defendants are nominal defendants but nevertheless by failing to appear herein in these proceedings and plead anything therein they have admitted the following things:

(a) That there was no consideration for the purported chattel mortgage from the bankrupt corporation to this appealing defendant, Leonard Woodruff, in the sum of eighteen thousand dollars ($18,000.00);

(b) That said chattel mortgage was not regularly authorized by the board of directors of bankrupt corporation at a regularly or specially called meeting for such purpose or at all;

(c) That the merchandise mortgaged consisted of stock in trade of a wholesale and retail merchant and cannot be mortgaged under section 2955, paragraph 3 of the Civil Code of the state of California.

(d) That the said chattel mortgage was fraudulent and void as to fixtures and store equipment, against existing creditors (it has been proved in this case that there were creditors, whose claims were in existence at the time of the execution of said chattel mortgage and are as yet unpaid and are filed as claims against the bankrupt estate) for the reason that seven days previous to the execution and delivery of the said chattel mortgage, no notice of intention to make said transfer was recorded in accordance with section 3440 of the Civil Code of the state of California, the particular section of which that applies here being:

"Provided, also, that the sale, transfer or assignment of a stock in trade, in bulk, or substantial part thereof, otherwise than in the ordinary course of trade and in the regular and usual classes and method of business of the vendor, transferror or assignor, and the sale, transfer, assignment or mortgage of the

> fixtures or store equipment of a baker, cafe or restaurant owner, garage owner, machinist or RETAIL OR WHOLESALE MERCHANT, WILL BE CONCLUSIVELY PRESUMED TO BE FRAUDULENT AND VOID as to the then existing creditors of the vendor, transferror, assignor or mortgagor, unless at least seven days before the consummation of such sale, transfer, assignment or mortgage, the vendor, transferror, assignor or mortgagor or the intended vendee, transferee, assignee or mortgagee shall record in the office of the county recorder in the county in which said stock in trade, fixtures or equipment are situated a notice of such intended sale, mortgage, etc."

With reference to appellant's fifth assignment of error, that the Special Master erred in making findings of fact that there was a large quantity of jewelry merchandise pledged to Leonard Woodruff to secure a total amount of thirty-three thousand three hundred forty-five and 44/100 dollars ($33,345.44), including interest to the date of findings, advanced at different times over a period of years by appellant Leonard Woodruff to bankrupt corporation as security for repayment to him of said sum, the evidence of the witness Calvin Smith [Tr. 171-2-3] shows that there was a total of approximately seventy-eight thousand dollars' ($78,000.00) worth of semi-precious stones pledged to secure said indebtedness and that any additional sums above eighteen thousand dollars ($18,000.00) were advanced by Leonard Woodruff at the time the bankrupt corporation was attempting to reorganize into the Golden State Gem Co. of Nevada, at which time of reorganization the said Leonard Woodruff agreed to accept two-thirds of 50% of Smith's interest in the new corporation in consideration of the return of the pledged stock; release of the void mortgage, but inasmuch

as said agreement was not in writing and the stock was not delivered, and the assets of bankrupt corporation did not pass to new corporation, said oral agreement had no legal effect and was unenforceable, inasmuch as the appellant Leonard Woodruff never at any time returned the pledged stock, never presented the note outstanding for payment, or made any effort to effect a fair, adequate, just and equitable accounting with bankrupt corporation other than by the means herein complained of, namely, he never made any effort to foreclose his lien on the pledged merchandise; never made any demand for payment [Tr. 172]; in view of all this, the court could reach no other conclusion than the one he did arrive at referred to in assignment of error V.

So far as the statement is concerned that said finding is erroneous for the reason that it is not within the issues of the case, that statement is ridiculous for the reason that it appears in all the evidence that the appellant Leonard Woodruff was amply secured for the money that he advanced to bankrupt corporation by virtue of the pledged stock and even if he did advance eighteen thousand dollars ($18,000.00) additional, which was not the case, this finding shows that the appellant Leonard Woodruff had already been secured for moneys advanced by having had pledged to him seventy-eight thousand dollars' ($78,000.00) worth of precious and semi-precious jewelry merchandise. The finding is the result of all the evidence adduced at the trial and is necessary to support the proposition that there was no true consideration for the chattel mortgage.

In appellee's original complaint, it is true he sought to have the determination made of the rights of the parties in the pledged property, but the same was withdrawn from the amended complaint for the reason that the same could be disposed of in summary proceedings before the Referee in Bankruptcy, and it should be noted here that the Special Master for trial is the same party as Referee in Bankruptcy and was in position to take judicial notice of a number of things that transpired between the parties to the litigation which are not in evidence and he would be the best judge as to their equitable rights, and it makes no difference whether the Special Master, as such, decreed the equitable rights of the parties in a summary proceeding in bankruptcy, or, in the case at bar, as such finding is the result truly and simply of all the evidence of the subject matter.

With reference to appellant's assignment of error number VI, to-wit: that the Special Master erred in making ing his conclusion of law I (Appellant's Brief, p. 11), this conclusion of law naturally follows and is the logical sequence; that since it has been estabished that the chattel mortgage was fraudulent and void and the sale resulting from the foreclosure proceedings void all lawful title to the property in question failed to pass and by operation of law at the time of adjudication of the bankrupt corporation, all of the property described in said chattel mortgage, vested in the appellee as trustee for the benefit of creditors of bankrupt estate. There is ample evidence of the ownership of said property prior to the execution and delivery of said chattel mortgage. Most all of the witnesses of

appellee testified that most all of the business was conducted in the building at number 726 South San Pedro street, Los Angeles, California.

The same answer that has been given with reference to the last portion of assignment of error V and all of VI can be applied to cover the points raised by assignment of Error VII, namely, that the Special Master erred in making his conclusions of law No. II, covering order of disposition of pledged stock (App. Brief, p. 11).

However, it is immaterial to appellee whether the court adjudicate as to the pledged stock as a Special Master or a Referee in Bankruptcy. In either event he would adjudicate the same way, based on his findings of fact in this proceeding, so there can be no error.

The same answer made to assignment of error VI can apply in answer to assignment of error VIII, namely, that Special Master erred in making his conclusion of law No. III, ordering an accounting from appellant of mortgaged property.

The reasons set forth on pages 12 to and including part of page 29 (Appellant's Brief), up to assignment of error X, which attempt to indicate that the District Court erred in overruling and denying the exceptions of Leonard Woodruff to findings of fact, conclusions of law and report of Special Master, made special reference to the pages of evidence in the original volumes of the transcript, taken at the trial which is not a part of the record upon appeal herein. Accordingly this Honorable Court is not even in position to inquire into the merits or demerits of any of said purported exceptions, and furthermore the

court in adopting the decision of the Special Master as the decision of the District Court did so, based upon his careful examination and perusal of the entire transcript of evidence, a very great portion of which has been for purposes favorable to the appellant kept out of the appellant's statement of evidence embodied in the transcript [Tr. 113].

In answer to assignment of error X it appears to be meaningless, as there are no errors specified (App. Brief, p. 29).

In answer to assignment of error XI it is covered by the answer given to assignment IV, V and VI.

In answer to assignment of error XII (App. Brief, pp. 29 and 30), inasmuch as the amended complaint states a cause of action, the Special Master, Earl E. Moss, did not err in accepting evidence in support thereof, and in overruling appellant's objections to the introduction of evidence.

The decision of the District Court objected to by assignment of error XIII in which appellant states that the said District Court erred in adopting and confirming the Special Master's report, and each and every finding and etc. (App. Brief, p. 31) naturally follows and is the legal sequel as shown by answers to IV, V and VI.

There is no merit whatsoever to assignment of error XIV, namely, that the court erred in adopting the recommendation of the Special Master and permitting the petitioner to file an amended petition. It is elementary as well as provided by section 473 of the Civil Code of Procedure that in the interest of justice the trial court may at any stage of the proceedings enter an order upon motion therefor granting either party to the action leave to amend pleadings. (473 C. C. P. applies because state court has concurrent jurisdiction with federal court in this kind of an action.)

ARGUMENT.

Appellant takes the position that bankrupt corporation is not a merchant within the purview of sections 2955 and 3440 of the Civil Code of the state of California and accordingly would have the right under the first section to mortgage its personal property and would not be required under the second section to record a seven-day notice of its intention to make said mortgage, pursuant to said section 3440. In addition to this position at the same time by his answer appellant has denied that the provisions of section 3440 of the Civil Code of the state of California were not complied with [see Tr. of Record, p. 71, par. IX].

Denies the failure to record seven-day notice of intention thereunder;

Denies the existence of certain creditors at the time of execution and delivery of said chattel mortgage and that their claims are still outstanding although there is no evidence of appellant to support either the position taken or the defense made. In other words, appellant has not only failed to establish by any evidence that bankrupt corporation is not a merchant within the purview of sections 2955 and 3440 of the Civil Code of the state of California, but he has also failed to prove a compliance with section 3440, pursuant to the issue raised by paragraph IX of appellant's answer [Tr. 71].

Appellant also takes the position that inasmuch as the president of bankrupt corporation is the *"alter ego"* of the corporation [Tr. 73, par. 2] it was not necessary to have the execution and delivery of said chattel mortgage regularly authorized at a meeting of the corporation's board of directors pursuant to section 8, of its by-laws

[Tr. 73, par. 2]. However, the evidence in this respect is that the mortgage was executed and delivered to appellant in the absence of three (3) of five (5) of the directors of bankrupt corporation, including that of the president himself, Walter Calvin Smith. The chattel mortgage is signed by A. S. Devoll, vice-president, and Mrs. C. E. Buck, secretary.

The facts stated, constituting the fraud in permitting the foreclosure of the mortgage to go by default is covered by the allegations set forth in paragraph XII of amended complaint [Tr. 60]. These allegations are proved by the evidence of all witnesses. Clearing the transfer, that was void in its inception, through foreclosure proceedings, did not cure the defects, inasmuch as the equitable interests of third parties were concerned. The propositions of law supporting these statements are set forth subsequently under the title in question.

In answer to appellant's statements on pages 40 to and including 50 of his brief, to-wit: that the court erred in overruling appellant's exceptions to the Special Master's report and erred in confirming said report and in entering a decree in favor of the plaintiff is embodied in appellee's propositions of law.

POINTS AND AUTHORITIES AND APPELLEE'S PROPOSITIONS OF LAW.

(1) **Jurisdiction.**

> "Under section 23a of the Bankruptcy Act the federal court has jurisdiction of suits at law or in equity between trustee in bankruptcy and 'adverse claimant,' concerning the property acquired or claimed by the trustee, in the same manner and to the same

extent only as though bankruptcy proceedings had not been instituted."

Section 23b of the Bankruptcy Act requires "consent of the proposed defendants" for such jurisdiction, but excepts suits to recover property or money preferentially or fraudulently transferred. The jurisdiction of a trustee's suit on one of these excepted cases is independent of the proposed defendant's consent, as well as the requirement for the diversity of citizenship, or any of the general grounds to acquire federal jurisdiction.

Cyclopedia of Federal Procedure, Vol. 1, page 574;
Judicial Code Laws of the U. S., paragraph 24 (1), U. S. C. A. 41 (1);
Toledo Fence & Post Co. v. Lyons, 299 Fed. 637;
Operators Piano Co. v. First Wisconsin Trust Co., 283 Fed. 904, 11 U. S. C. A. 96b, 107e;
Bankruptcy Act, paragraphs 60, 67 and 70;
Golden Hill Distilling Co. v. Logue, 243 Fed. 342;
Kraver v. Abrahns, 203 Fed. 782;
Milkman v. Arthe, et al., 213 Fed. 642, 223 Fed. 507;
Harley, et al. v. Devlin, 149 Fed. 268;
Johnston v. Forsyth Mercantile Co., 127 Fed. 845;
Price v. Coolidge Banking Co., et al., 242 Fed. 175;
Hawkins v. Dannenberg Co., et al., 234 Fed. 752;
Winstow v. Stabb, et al., 233 Fed. 304;
Brent, et al. v. Simpson, 233 Fed. 285.

(2) **Sufficiency of Amended Complaint and Proof.**

Amended complaint states facts sufficient to constitute a cause of action against appellant.

(a) Trustee in bankruptcy may maintain an action to set aside a fraudulent conveyance.

> *Ballau v. Andrews Baking Co.*, 128 Cal. 562;
> *Ruggles v. Cannedy*, 127 Cal. 290;
> *Davis v. Winona Wagon Co.*, 120 Cal. 244.

(b) Section 2955, Civil Code of the state of California:

> "Mortgages may be made upon all growing crops, including grapes and fruit, and upon any and all kinds of personal property, except the following:
>
> 1. Personal property not capable of manual delivery.
> 2. Articles of wearing-apparel and personal adornment.
> 3. The stock in trade of a merchant. 1909–34."

(c) Section 3440, Civil Code of the state of California, which provides that a transfer is fraudulent and void against existing creditors unless at least seven (7) days before the consummation of such sale, or mortgage, the mortgagor records in the office of the county recorder, notice of said intention to mortgage, sell or transfer, stating the time, the name and address of the parties to the instrument and the character of the merchandise or property intended to be sold, transferred or mortgaged.

(d) Section 3007 of the Civil Code of the state of California (with reference to the disposition of pledged stock):

> "Whenever property pledged can be sold for a price sufficient to satisfy the claim of the pledgee, the pledgor may require it to be sold, and its proceeds to be applied to such satisfaction, when due."

(e) Section 320a, Civil Code of the state of California, as being the law effecting section 9 of bankrupt corporation by-laws, section 9, follows:

> "When all the directors of a corporation are present at any directors' meeting, however called or noticed, and sign a written consent thereto, on the record of such meeting, or if the majority of the directors are present, and if those not present sign in writing a waiver of notice of such meeting, whether prior to or after the holding of such meeting, which said waiver shall be filed with the secretary of the corporation, the transactions of such meeting are as valid as if had at a meeting regularly called and noticed. 1929."

(f) The court finds a fraudulent intent from the evidence adduced.

Cioli v. Kenouigios, 39 Cal. App. Dec. 376;
Henneway v. Thaxter, 150 Cal. 737.

(g) The complaint shows that appellee represents injured creditors as trustee in bankruptcy arising from the fraudulent transfer.

First National Bank v. Eastman, 144 Cal. 487;
Gray v. Brunnold, 140 Cal. 615;
Horn v. The Volcano Water Co., 13 Cal. 62.

(h) Fraud is generally concealed and hard to prove; if the rational inference from the evidence is the existence of an intent to defraud, it is sufficient.

Rossen v. Villanueva, 175 Cal. 632;
Title Insurance, etc. Co. v. ...., 171 Cal. 173;
Bush & Mallet Co. v. Helfing, 134 Cal. 676.

(i) In a suit by trustee of bankrupt corporation, to recover assets illegally transferred, a decree held proper which required defendant to pay such sum as might be required with the other assets to pay expenses of administration and all just claims, exclusive of claims of stockholders who participated in the illegal transfer.

299 Fed. 106.

(j) Claims of creditors need not be reduced to judgment to entitle the bankrupt's trustee to set aside bankrupt's conveyance as fraud on creditors.

11 Fed. Second 2 N. B. 984.

(3) The Special Master's findings must be taken *prima facie* to be correct.

McNulty v. Wilson, 158 Fed. 221.

Every reasonable presumption is in their favor; and they are not to be set aside or modified, unless there clearly appears to have been error on the Special Master's part.

125 U. S. 149, 31 L. Ed. 664;

Callaghan v. Meyers, 128 U. S. 666, 32 L. Ed. 547;

Crawford v. Neal, 144 U. S. 596, 36 L. Ed. 552;

Doris v. Schwartz, 155 U. S. 636, 39 L. Ed. 289;

Girard Ins. Co. v. Hooper, 162 U. S. 538, 40 L. Ed. 1062.

Equity Rule Number Sixty-five Prescribes the Master's Right to Examine Any Witness in Order That the Evidence May Be Used by the Court If Necessary. This Rule Succeeded Old Equity Rule Number Eighty-one of Federal Equity Procedure of the United States District Court.

With reference to the amendment of appellee's complaint, section 473 of the Code of Civil Procedure of the state of California in part states: "The court may likewise in, its discretion, after notice to the adverse party, allow, upon such terms as may be just, an amendment to any pleading or proceeding in other particulars," etc. The record shows [Tr. 48-52-53] that the amendment was allowed on a motion by appellee (notice waived). This section (473 C. C. P.) of the state court applies for the reason that the state court had concurrent jurisdiction with the federal court in this kind of a proceeding.

> "The purpose of a special reference for trial of a case of this nature is to economize the time and labor of the District Court. When counsel makes his exceptions to any decision or finding of the Special Master so confusing, so general, as to require the District Court or Circuit Court of Appeals to practically rehear the matter anew, which on its face is really simple, and thereby nothing is saved by the reference, exceptions under such conditions will be denied under 151 U. S. 285, to and including 291, 38 L. Ed. 164, 166."

> "The exceptions must state article by article those parts of the report which are intended to be excepted to."
>
> *Story v. Livingston,* 10 L. Ed. 200;
>
> *Walker v. Rogers,* 6 Johns. 566.

POWERS AND DUTIES OF SPECIAL MASTER.

21 C. J. 601, paragraph 745-2:

> "The powers of a Master are usually derived from, and confined to, the terms of the order of reference, and he cannot, by consent of the parties, acquire any authority beyond such order."

Carr v. Fair, 122 S. W. 657;

Lindsey v. Swift, 119 N. E. 787;

Hards v. Burton, 79 Ill. 504;

..................................follow from 21 C. J. 601.

> "Beside doing acts which are merely ministerial he does perform functions which are of a judicial nature, such as passing upon the competency of evidence, and making findings of law and fact, where a cause is referred to him to take and report the proofs with his conclusions of law and fact, and therefore, it may be properly said that he is an officer performing both judicial and ministerial functions. A Master acts within his province in making such rulings of law as he deems necessary for a full trial of the issues."

Ellwood v. Walter, 103 Ill. A, 219;

Citizens State Bank v. Joplin, 198 S. W. 370;

Snow Iron Works v. Chadwick, 116 N. E. 801.

(4) A void judgment may be avoided by strangers or one claiming to be a *bona fide* creditor or his trustee, when it can be shown that the judgment was obtained by collusion between the plaintiff and defendant.

109 Fed. Rep. 177;

Estate of Pusey, 180 Cal. 358;

Forbes v. Hyde, 31 Cal. 342;

Bennett v. Wilson, 122 Cal. 509;

Kieiss v. Hotaling, 96 Cal. 617;

People v. Green, 74 Cal. 405.

(5) The rule on appeal is that the findings of the trial court cannot be successfully assailed unless they are contrary to the undisputed evidence read in the light of all legitimate inferences.

Atkinson v. Western D. Syndicate, 170 Cal. 503;
Phenegan v. Pavlini, 27 Cal. App. 381;
Benson v. Harriman, 55 Cal. App. 483.

CONCLUSION.

In conclusion appellee submits, after carefully examining all of the points raised in appellant's brief, by way of assignment of errors, no error is found, and it appears from the examination of the entire record, including the pleadings and evidence, although appellant has failed to certify any of the exhibits for examination, that the findings of fact by the Special Master were borne out by the testimony, and that the conclusions of law were justified by such findings; that the order and decree of the District Court adopting the same as the decision of said court was proper and said findings and facts and conclusions of law of the Special Master and the decree of the District Court should therefore be by this court affirmed, without leave to appellant to proceed any further by way of attempting to prosecute an appeal upon any questions herein to the Supreme Court of the United States, as it has been called to the attention of appellee that appellant threatens to do so, for the sole and only purpose of continuing to harass, hinder and delay the creditors represented by appellee herein as trustee in bankruptcy.

Respectfully submitted,

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